



# C I A Training

## September 2014

### **Presenter Dorian Humphrey**

Sr. Underwriter

U.S. Department of Housing & Urban Development

Atlanta Homeownership Center





# Disclaimer

The purpose of this presentation is to provide a basic overview of qualifying guidelines for credit, income, and assets, focusing on clarifying and explaining existing and recent changes in FHA policy. It restates and explains, rather than supersedes, official policy issued in Handbooks and Mortgagee Letters. Please note that the information provided in this training is subject to change.





# FHA RESOURCES

There is a variety of ways to get FHA information

- Online FAQ Site: **[www.hud.gov/answers](http://www.hud.gov/answers)**
- Email: **[answers@hud.gov](mailto:answers@hud.gov)**
- Telephone: **(800) CALL- FHA (5342)**
- Email Updates: **<http://bit.ly/FHARCPage>**



# References

- HUD Handbook 4155.1
- Mortgagee Letters
  - 2012-03
  - 2012-10
  - 2012-15
  - 2013-05
  - 2013-14
  - 2013-24
  - 2013-25
  - 2013-26



# C I A

- Credit
- Income
- Assets



# CREDIT

Has the applicant demonstrated responsible management of their liabilities as reflected in their credit history?





# CREDIT

- ❖ Although acceptable credit is required, a loan cannot be rejected due to lack of credit. However, the file must document that the lender attempted to develop a satisfactory history of non-traditional credit
- ❖ FHA credit requirements provide guidance, but also lend themselves to flexibility when justified
- ❖ The underwriter is responsible for adequately analyzing the probability that the borrower is able to repay the mortgage obligation in accordance with the terms of the loan



## TRADITIONAL AND NON-TRADITIONAL CREDIT

- ❖ There are two types of traditional credit reports used:
  - ❖ three repository merged credit report, also known as a "tri-merged" credit report (TRMCR), and Residential Mortgage Credit Report (RMCR).
  - ❖ The minimum credit report required by FHA is a "three repository merged" in-file credit report (TRMCR)
- ❖ The file must be submitted with an original copy of the credit report and include all credit that is available in the repositories accessed
- ❖ The credit report must provide an account of the credit, residence history, and public records information.



## **RESIDENTIAL MORTGAGE CREDIT REPORT**

**A residential mortgage credit report (RMCR) is required when the**

- ❖ borrower disputes the ownership of accounts on TRMCR
- ❖ borrower claims that collections, judgments, or liens listed as open have been paid, and documentation supporting his/her claim is not available
- ❖ borrower claims that certain debts on TRMCR have different balances/payments, and current statements less than 30 days old supporting his/her claim are unavailable,
- ❖ underwriter determines that it is more prudent to use an RMCR than a TRMCR to underwrite the loan



## RED FLAGS

- ❖ Whiteouts, erasures, or alterations
- ❖ Mismatched personal information (SSN, residence, employment)
- ❖ All or most debts recently paid off without documented acceptable source of funds
- ❖ Check for duplicate records
- ❖ Possible non-applicant debt (authorized users)
- ❖ Unexplained recent inquiries



# NON-TRADITIONAL CREDIT

- ❖ The use of non-traditional credit references must be documented carefully. It may not be used to enhance the credit of borrowers with poor payment history or to “manufacture” a credit report for those without a verifiable credit history. Nor is it designed to offset derogatory credit found on a traditional credit report such as collections and judgments
- ❖ It is designed to assess the credit history for borrowers without the types of trade lines that normally appear on a traditional credit report



# NON-TRADITIONAL CREDIT

**Sufficient credit references for non-traditional credit reports may include (but are not limited to)**

- ❖ rental housing payments subject to an independent source (landlord)
- ❖ utility company references
- ❖ insurance premiums not payroll deducted
- ❖ child care payments made to businesses
- ❖ school tuitions



# NON-TRADITIONAL CREDIT

- ❖ This alternative credit documentation should include a minimum of 3 sources and all must have a 12-month history
- ❖ No history of delinquent housing payments
- ❖ No more than 1x30 day late on consumer debt
- ❖ No collection accounts or public records reporting (other than medical) filed within the past 12 months



# CREDIT SCORES

- ❖ When a credit score is available, it must be used to determine eligibility for FHA insured financing
- ❖ Loans with a decision credit score below 620 AND a debt-to-income ratio in excess of 43% must be manually underwritten, even if TOTAL delivers an Accept scoring recommendation (ML 2013 - 05)
- ❖ Effective with case numbers assigned on or after April 24, 2014, qualifying ratios and compensating factors are subject to limits based on credit score for manually underwritten loans (ML 2014-02)



# LIABILITIES

- ❖ The information on the credit report must be reported properly on the 1003.
- ❖ Any other credit noted by the applicant that may not appear on the credit report (i.e. new car loan, private loan, etc.) must be verified and included as a liability
- ❖ Co-signed accounts do not have to be included in the debt if you verify a 12 month history and verify payments are being made by the primary obligor



# LIABILITIES

- ❖ Court-ordered assignment of debt does not have to be included in the ratios if you obtain the divorce decree and evidence of the transfer of ownership
- ❖ For mortgage assumptions, if the mortgage assumption does not provide a release of liability clause, then you must document a 12-month satisfactory payment history in order to not include the payment in the total DTI ratio
- ❖ Authorized user accounts should not be included in a borrower's liabilities



# LIABILITIES

- ❖ If the credit report does not reflect a monthly payment on any open account (e.g., Amex), then 5% of the balance or \$10, whichever is greater, is to be used
- ❖ A statement reflecting the terms or minimum payment due is acceptable documentation
- ❖ Deferred student loans are not included in the debt-to-income (DTI) ratios if the deferment is verified for a minimum of 12 months from the closing date
- ❖ Leased payments (particularly auto leases) should typically be included in the DTI regardless of the remaining term



# LIABILITIES

- ❖ If there is a business debt in the borrower's name, then the payment must be included in the total DTI ratio unless the borrower can provide documentation evidencing the obligation is paid from the company funds (except when a sole proprietor has filed a scheduled C with their personal income tax returns)
- ❖ This can be done by obtaining a letter from the accountant and 12 months canceled checks; in addition to having a satisfactory payment history



# **BANKRUPTCY**

A bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage, provided that the lender documents that:

- ❖ A Chapter 7 bankruptcy has been discharged at least 2 years and the borrower has reestablished satisfactory credit
- ❖ Under a Chapter 13 bankruptcy , at least 1 full year has elapsed with satisfactory payment made and the borrower has received court approval to enter into the mortgage transaction





# FORECLOSURES

- ❖ Foreclosures must not have occurred within the previous 3 years
- ❖ Lenders may grant an exception to the 3 year rule if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower, such as a serious illness or death of a wage earner, and the borrower has re-established good credit since the foreclosure



# FORECLOSURES

- ❖ The 3 year rule for foreclosures does not begin on the date reported on the credit report, but starts from the date the borrower actually lost title (foreclosure sale date)
- ❖ Divorce is not considered an extenuating circumstance. An exception may, however, be granted where a borrower's loan was current at the time of his/her divorce, the ex-spouse received the property, and the loan was later foreclosed
- ❖ Also, the inability to sell the property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance



# SHORT SALES

- ❖ A borrower is not eligible for a new FHA-insured mortgage if they pursued a short sale agreement on their principal residence simply to take advantage of declining market conditions, and purchase a similar or superior property within a reasonable commuting distance at a reduced price as compared to current market value.



# SHORT SALES

- ❖ A borrower is considered eligible for a new FHA-insured mortgage if, from the date of loan application for the new mortgage, all
  - ❖ mortgage payments on the prior mortgage were made within the month due for the 12-month period preceding the short sale, and
  - ❖ installment debt payments for the same time period were also made within the month due



# SHORT SALES

- ❖ A borrower in default on his/her mortgage at the time of the short sale (or pre-foreclosure sale) must comply with the same guidelines as a regular foreclosure, in which they are eligible for a new FHA-insured mortgage for three years from the date of the pre-foreclosure sale.



# STUDENT LOANS

- ❖ If the borrower is currently delinquent on their federal student loan, then the borrower is *not* eligible until the loan is brought current, paid, or otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the agency owed

**NOTE:** Loans in forbearance are not necessarily considered delinquent debt. It is the underwriter's responsibility to verify and document the current status of the student loan



# JUDGMENTS

- ❖ ML 2013-24
- ❖ Court ordered judgments reflected on the borrower's credit report must be satisfied **prior to the insuring** of the loan to ensure that the FHA loan has first lien position.
- ❖ If not paid, then a satisfactory payment arrangement made between the borrower and the creditor is acceptable
- ❖ The file must include written evidence of the payment arrangement evidencing the terms and monthly payments



# JUDGMENTS

- ❖ The file must include written evidence that scheduled payments have been made on time for at least 3 months prior to credit approval
- ❖ Borrowers may not prepay scheduled payments in order to meet the required minimum 3 months of payments.
- ❖ The underwriter must ensure that the payment is included in the borrower's total DTI
- ❖ Judgments of non-borrowing spouses in community property states must be paid in full or be under a payment plan unless excluded by state law.



# COLLECTIONS

- ❖ ML 2013-24
- ❖ Not required to be paid off **but**, unpaid collections could affect borrower's ability to repay mortgage
- ❖ If total amount of collections is equal to or greater than \$2,000, lender must perform capacity analysis
- ❖ Unless excluded by state law, collections of non-borrowing spouses in community property states are included in the balance
- ❖ ***Medical collections and charge off accounts are excluded and do not require resolution***



# COLLECTIONS

**Capacity analysis includes any of the following actions:**

- ❖ At or prior to closing, account is paid in full
  - ❖ verification of acceptable source of funds used is required
- ❖ Borrower makes payment arrangements with creditor
  - ❖ Must be verified through credit report or letter from creditor
  - ❖ Monthly payment must be included in DTI ratio
- ❖ Calculate monthly payment of 5% of each collection and include in DTI ratio





# DISPUTED DEROGATORY ACCOUNTS

- ❖ ML 2013-24
- ❖ Defined as:
  - ❖ disputed charge off accounts
  - ❖ disputed collection accounts
  - ❖ disputed accounts with late payments in the last 24 months
- ❖ Disputed accounts are excluded by TOTAL and must be analyzed by the lender
- ❖ Borrower must provide letter of explanation and documentation supporting the basis for the dispute



# **DISPUTED DEROGATORY ACCOUNTS**

**Loan must be downgraded to a Refer and manually underwritten where:**

- ❖ Cumulative balance of disputed derogatory accounts is \$1,000 or more
- ❖ Disputed accounts of a non-borrowing spouse in a community property state are not included in balance
- ❖ Disputed medical accounts are excluded
- ❖ Disputed accounts stemming from card theft or identity theft are excluded
  - ❖ File must contain information supporting the dispute



# CREDIT DOCUMENTATION

- ❖ When reviewing the borrower's credit pay close attention to any patterns of credit use and abuse. The last 12-24 months of the credit history should be carefully analyzed
- ❖ Explanations for derogatory credit must make sense and be consistent with other documentation in the file
- ❖ Pay close attention to dates and events. For example, if the borrower claims that a pattern of late payments was the result of loss of income, then cross check and document any gaps in the employment history or interruption of other income sources.



# CREDIT DOCUMENTATION

- ❖ It is the Direct Endorsement (DE) underwriter's responsible for determining and documenting the creditworthiness of a borrower, which includes analyzing a borrower's overall pattern of credit behavior
- ❖ When a borrower is approved, the DE underwriter is responsible for recording the results of the credit analysis on the HUD-92900-LT, FHA Loan Underwriting and Transmittal Summary
- ❖ Any modification of the mortgage amount or approval conditions under "Underwriter Comments" on the form, and approves the borrower and authorizes closing, if the case is a DE case





## **BACK TO WORK – EXTENUATING CIRCUMSTANCES**

- ❖ Provides guidance on treatment of borrowers who might otherwise be deemed ineligible, but who experienced an “economic event
- ❖ An “economic event” is defined as an occurrence beyond the borrower’s control that resulted in a loss of employment, income, or a combination of both that resulted in a reduction of household income of 20% or more for six months or more
- ❖ Housing counseling required as a condition of approval under this Back to Work criteria
- ❖ Refer to ML 2013-26 for specific definitions and policies





# **MORTGAGE CREDIT REJECT**

When a borrower is rejected for unacceptable credit characteristics on the basis of information contained in his/her credit report as well as for income and assets the underwriter is responsible for completing the Mortgage Credit Reject screen in FHA Connection.





# INCOME

- ❖ The borrower's employment and income must be **stable** and **verifiable**
- ❖ All income considered in the loan approval must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan
- ❖ Income that **cannot** be verified, is not stable, or will not continue, may not be used in the loan approval



# INCOME

- ❖ The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31% of the gross effective income
- ❖ The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring monthly obligations do not exceed 43% of the gross effective income



# INCOME

- ❖ FHA requires a 2-year work history for each borrower
- ❖ Each file must include a Verification of Employment (VOE) as well as the most recent 30-day YTD paystub(s) for each borrower in order to support the income used for qualifying



# INCOME

If the income is stated as:	Then use the following calculation:
Annual	Base pay divided by 12
Weekly	Base pay X 52 (pay periods) divided by 12
BI-Weekly (every 2 weeks)	Base pay X 26 (pay periods) divided by 12
Semi-Monthly (twice a month)	Base pay X 24 (pay periods) divided by 12
Hourly	Base pay X number of hours worked per week X 52 divided by 12



# INCOME

What to look for	What to do
Name	Compare to 1003 and any 3 <sup>rd</sup> party and make sure they match
Social Security Number	Compare to 1003 and any 3 <sup>rd</sup> party and make sure they match
Pay Period	<ul style="list-style-type: none"><li>• Ensure that you have consecutive paystubs</li><li>• Use to determine how much the borrower is being paid</li></ul>
Year-to-Date Income	<ul style="list-style-type: none"><li>• Match against base pay and W-2</li><li>• Does the equals year-to-date, or is it short? Why is it short?</li></ul>



# Income

What to look for	What to do
Deductions, repayments, garnishments	Include with liabilities on 1003 and in debt-to-income ratios
Additional income not disclosed that may be needed to qualify	<ul style="list-style-type: none"><li>• Determine the source: overtime, bonus, shift differential, etc.</li><li>• Calculate based on year-to-date income</li><li>• Compare against W-2s</li></ul>
Employer	Compare to 1003 and make sure they match
W-2: Employer/Employee	Make sure the name and address match paystubs and 1003



# Income

What to look for	What to do
W-2: Social Security Number	Make sure it matches paystub and 1003
W-2: Annual Income	Make sure it is in line with year-to-date earnings on paystub



## **RED FLAGS**

**Things to be concerned with include:**

- ❖ Handwritten checks
- ❖ Round dollar amounts
- ❖ Inconsistent Check Numbers
- ❖ Different font types within the document



# INCOME DOCUMENTATION

- ❖ Verification/documentation of income is either standard or alternative
- ❖ Standard: Written verification of employment (VOE), and the borrower's most recent pay stub covering a 30-day period
- ❖ Alternative: Verbal verifications by telephone for all current employers (all items on VOE should be addressed), the pay stub(s) reflecting the borrower's name and SSN covering the most recent thirty-day period, and copies of the previous two years W-2 forms



# INCOME DOCUMENTATION

- ❖ Any gaps in employment must be explained in writing by the borrower(s) and must make sense in regards to the borrower's work history
- ❖ Any income discrepancies between the VOE and supporting documentation must be satisfactorily explained by the employer and documented in the file



# TYPES OF INCOME

## Employment Income

- ❖ Salary
- ❖ Part Time
- ❖ Overtime
- ❖ Bonus
- ❖ Commission
- ❖ Self Employment



# TYPES OF INCOME

## Non-Employment Income

- ❖ Social Security
- ❖ Disability Benefits
- ❖ Alimony & Child Support
- ❖ Notes Receivable
- ❖ Trust Income
- ❖ Dividends & Interest
- ❖ Foster Care Income
- ❖ Public Assistance
- ❖ Automobile Allowance
- ❖ Rental Property Income



# OVERTIME AND BONUS INCOME

- ❖ Both may be used to qualify if consistent, continuing, and has been received over the most recent two-year period
- ❖ Must be averaged over the most recent two-year period A period less than two years may be used on a case-by-case basis, but the DE underwriter must reasonably justify and document in the file
- ❖ If income varies significantly from year-to-year, a period of more than two years must be used in calculating the average income



# COMMISSION

- ❖ Commission income must be averaged over the previous two years, and must be continuing
- ❖ Commissions earned less than one year are not considered effective income
- ❖ The borrower must provide two years tax returns along with a recent pay stub
- ❖ Un-reimbursed business expenses must be subtracted from gross income





## **PART-TIME INCOME**

- ❖ Income from a part-time (second) job may be used to qualify if it is uninterrupted
- ❖ The underwriter must average the part-time (second) job income over the past two years. A period less than two years may be used on a case-by-case basis, but the underwriter must justify and document the file
- ❖ Seasonal employment may be used if the borrower has worked the same type of job for the past two years and expects to be rehired during the next season



# TEMPORARY INCOME

- ❖ Temporary Agency income must be carefully considered as, by definition, the source of income is varying and stability may be at issue
- ❖ Income earnings from a temporary agency may be used for qualifying if it is consistent, continuing, and has been received over the most recent two-year period
- ❖ The employment and income must be expected to continue without obstruction of assignment expiration or reassignment, or any other known circumstance resulting in loss of income.



# TEMPORARY INCOME

- ❖ Income earnings from a temporary agency may not be declining
- ❖ Most recent 2 years of borrowers tax returns are required



# UNEMPLOYMENT

- ❖ When using unemployment income, it must be documented for two years, and there must be reasonable assurance that this income will continue
- ❖ This requirement may apply to seasonal employment (e.g. seasonal, ski resort, construction)
  - ❖ Documentation: Copies of letters or exhibits from the paying agency, or tax returns
  - ❖ Calculation: As stated in the document used for verification. If taken from the tax returns - divide by 24



# MILITARY INCOME

- ❖ Verification of employment/enlistment is required  
Leave and earning statement will provide tour of duty expiration date
- ❖ In addition to the base pay, income may include variable housing allowances, clothing allowances, flight or hazard pay, rations, and proficiency pay provided its continuance is verified
- ❖ Any unexplained allotment from pay must be verified through the personnel office
- ❖ Any pay advance must be explained and documented



# SELF-EMPLOYMENT INCOME

- ❖ To determine if the borrower's business is expected to generate sufficient income for his/her needs, the lender must carefully analyze the business's financial strength, including the source of the business's income general economic outlook for similar businesses in the area.
- ❖ Declining income is usually not acceptable and must be carefully analyzed. Unless it is reasonably explained and documented, declining income may not be used for qualifying purposes. At the time of underwriting, it must be apparent that the decline was due to an exceptional, non-reoccurring event and does not impact upon the borrower's potential for future earnings



# SELF-EMPLOYMENT INCOME

- ❖ Self-employed borrower's must be verified and documented via tax returns (individual and federal business) covering the most recent 2 year period as well as an YTD profit & loss (P&L) statement (if more than a calendar quarter has elapsed since the date of the most recently filed calendar or fiscal-year end tax return

***REFERENCE:*** Mortgagee Letter 2012 -03



# SELF-EMPLOYMENT INCOME

Type	What to document
Sole-proprietorship/ Independent Worker	<ul style="list-style-type: none"><li>❖ Most recent two (2) year's tax returns</li><li>❖ Profit and Loss statement</li><li>❖ 1099 Forms</li><li>❖ Year-to-date paystub covering the most recent 30 day period</li><li>❖ Copy of current contract</li><li>❖ Reasonable expectation that income will continue for at least three years</li></ul>
Corporation	<ul style="list-style-type: none"><li>❖ Most recent two (2) year's personal tax returns</li><li>❖ Most recent two (2) year's corporate tax returns</li><li>❖ Profit and Loss statement</li><li>❖ Business credit report</li></ul>



# SELF-EMPLOYMENT INCOME

Type	What to document
Partnership	<ul style="list-style-type: none"><li>❖ Most recent two (2) year's personal tax returns</li><li>❖ Most recent two (2) year's partnership tax returns with K-1 forms</li><li>❖ Profit and Loss statement</li><li>❖ Business credit report</li></ul>



## RED FLAGS

- ❖ Missing borrower and/or employer name as well as missing/inaccurate addresses on pay stub(s)
- ❖ personal information not in agreement with other documentation in file (such as SSN)
- ❖ Inconsistent income based on type of employment (such as bonus or income increases) and/or with W2/IRS 1099/IRS 1040 income
- ❖ Handwritten checks and handwritten tax returns prepared by a professional tax preparer
- ❖ Typed W-2s with computer-generated pay stubs
- ❖ Unsigned and undated tax returns



# NON-EMPLOYMENT INCOME

- ❖ Non-Taxable income may be grossed up
  - ❖ Do not assume retirement income is non-taxable. If other than Social Security, document the taxing status
- ❖ The percentage of non-taxable income that may be added cannot exceed the appropriate tax rate for the income amount
- ❖ Additional allowances for dependents are not acceptable.

**NOTE:** If the borrower is not required to file a Federal tax return, the tax rate to use is 25%.





# RETIREMENT/PENSION/SOCIAL SECURITY/ DISABILITY INCOME

- ❖ The income may be received as a retirement benefit, a disability benefit, and/or as a custodial benefit. Veteran's retirement or veteran's widow death benefits are acceptable sources of income
- ❖ Verification from the source (former employer, Social Security Administration) or last two years of federal tax returns



# **SOCIAL SECURITY INCOME**

**Lenders must verify SSI by obtaining at least one of the following documents:**

- ❖ Federal tax returns
- ❖ the most recent bank statement evidencing receipt of income from the SSA
- ❖ A Proof of Income Letter (Budget or Benefit Letter) that evidences income from the SSA
- ❖ A copy of the borrower's Social Security Benefit Statement (SSA-1099/104S)



# SOCIAL SECURITY INCOME

- ❖ This income must continue for the first three years of the loan (disability income requires additional documentation)
- ❖ For SSI lenders must document the continuance by obtaining:
  - ❖ A copy of the last Notice of Award letter stating the SSA's decision on the borrower's eligibility for the SSA income; or
  - ❖ Equivalent documentation establishing the award benefits due to the borrower
- ❖ If any income from the SSA is due to expire within 3 years from the date of mortgage application, then that income may only be considered as a compensating factor



# DISABILITY INCOME

- ❖ When documenting the likelihood of continuance for disability income the lender should not request additional documentation from the borrower to demonstrate continuance of the SSA income
- ❖ Pending or current re-evaluation of the borrower's medical benefit is not considered an indication that the benefit payment is not likely to continue

**REFERENCE:** Mortgagee Letter 2012 - 15





# ALIMONY/CHILD SUPPORT INCOME

- ❖ A copy of the divorce decree, legal separation agreement, or voluntary payment agreement is required
- ❖ Evidence that payments have been received during the last 12 months includes (cancelled checks, deposit slips, tax returns, and court records)
  - ❖ Less than 12 month history may be used if the income provided you can adequately document the payer's ability and willingness to make timely payments
- ❖ May be grossed by the documented tax rate used to calculate the previous year's income tax return



# RENTAL INCOME

- ❖ Rents acquired in the current tax year must have valid one (1) year lease
  
- ❖ Vacancy/Maintenance factor applied to gross rent
  - ❖ 15% in Philadelphia's HOC jurisdiction
  - ❖ 15% in Atlanta's HOC jurisdiction
  - ❖ 15% in Santa Ana's HOC jurisdiction
  - ❖ 25% in Denver's HOC jurisdiction



# RENTAL INCOME

**EXAMPLE:** Based on the lease agreement provided:

- ❖ the borrower is charging a rent amount of \$750
- ❖ The mortgage payment is \$412.50 (PITI)
- ❖ AHOC's 15% reduction for vacancies and repairs

$$\begin{array}{r} \$750.00 \times 85\% = \$637.50 \text{ (Reduction for vacancies/repairs)} \\ \$637.50 \\ - \quad \underline{412.50} \text{ (Current monthly PITI)} \\ \$225.00 \text{ (Borrower's monthly gross} \\ \text{rental income)} \end{array}$$



# RENTAL INCOME

- ❖ Rents received prior to the current tax year
  - ❖ Must be evidenced by tax returns (Schedule E)
  - ❖ If rental property has been owned for two or more tax seasons, then at least two years of tax returns must be provided
  
- ❖ Vacancy/maintenance factor not applicable when tax returns are used



# RENTAL INCOME

- ❖ Per Mortgagee Letter 2008-25, rental income from existing properties being vacated may only be considered if the borrower either has sufficient income to make both mortgage payments minus any rental income or has an equity position not likely to result in defaulting on the rental property
- ❖ Exceptions to this rule may be considered if:
  - ❖ The borrower is relocating to an area not within reasonable and locally recognized commuting distance; or
  - ❖ The borrower has a sufficient equity in the vacated/rented property (75% or less LTV)



# OTHER INCOME

- ❖ Other acceptable income includes public assistance, foster care, and housing allowances
- ❖ A copy of a letter from the paying agency/organization must be provided evidencing the income will continue for the next three years



# AUTOMOBILE ALLOWANCES

- ❖ Only the amount by which the borrower's automobile allowance or expense account payments exceed actual expenditures may be considered income
- ❖ To establish the amount to add to gross income, the borrower must provide IRS Form 2106, Employee Business Expenses, for the previous two years and employer verification that the payments will continue
- ❖ If the borrower uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income



# ASSETS

- ❖ Borrowers are required to invest at least 3.5% of their own funds into the loan transaction as well as have sufficient funds to close
  - ❖ funds may not include closing costs paid outside of closing
- ❖ Acceptable sources of funds to close may include cash savings, investment, and retirement accounts, collateralized loans, secondary financing, and gift funds
- ❖ All funds to close must be properly verified (i.e. verification of deposit or recent bank statements)



# ASSET VERIFICATION

- ❖ Standard verification includes verification of deposit and most recent bank statement(s)
- ❖ A faxed VOD must comply with FHA guidelines
- ❖ Borrower to explain and document balance discrepancies (including large increase or decrease) with the accompanying bank statement
- ❖ Borrower to explain/document recently opened account and source of funds





# ASSET VERIFICATION

- ❖ Bank statements:
  - ❖ Cannot be more than 120 days old when loan closes on existing properties
  - ❖ Cannot be more than 180 days old when loan closes on new construction properties
  - ❖ Must provide all pages
  - ❖ Must reflect owners, dates covered, account number, all transactions for time period
- ❖ Explanation of Non-Sufficient Funds (NSF), over-draft protection usage, names of account owners, etc. must be provided



# ALTERNATIVE DOCUMENTATION

- ❖ Must cover 3 consecutive months
  - ❖ May be satisfied with 2 bank statements – as long they reflect the transactions/balances during 3 consecutive months)
- ❖ Cannot be more than 120 days old when loan closes on existing properties
- ❖ Cannot be more than 180 days old when loan closes on new construction properties



# ALTERNATIVE DOCUMENTATION

- ❖ Must provide all pages
- ❖ Must reflect owners, dates covered, account number, and all transactions for time period
- ❖ Explanation of NSF incidents, over-draft protection usage, names of account owners, etc.
- ❖ Consider outstanding large checks for earnest money, debt payments, etc.
- ❖ Be alert for regular payments not reflected on credit report/URLA (may be unreported debt)



# SOURCES OF ASSETS

## Asset Types Include:

- ❖ Checking
- ❖ Savings
- ❖ Certificate of Deposit (CDs)
- ❖ Money Market Accounts, Mutual Funds
- ❖ Stocks/Bonds
- ❖ Retirement: 401K, IRA, Keogh, SEP
- ❖ Trust
- ❖ Sale of Assets: Any tangible item with an appraised market value
- ❖ Gifts and Grants
- ❖ Interested party Contributions





# SECURED LOANS

- ❖ The use of life insurance policies, 401K's, retirement accounts, CD's, stocks, bonds, etc. may be used as security for a loan, and the loan proceeds may be used in the mortgage transaction
- ❖ Payments for these liabilities need not be included in the long-term debt and DTI as long as a copy of the loan agreement stating terms and financial asset as security is obtained and repayment is not required. If repayment is required the payment must be included in the DTI
- ❖ If the borrower intends to use the same asset to fulfill the reserve requirement, the value of the asset must be reduced by the amount of the loan



# **SALE OF PERSONAL PROPERTY**

**Documentation must be obtained evidencing:**

- ❖ Proof of ownership
- ❖ Third party verification of the value of the asset
- ❖ Evidence of sale/bill of sale of the asset
- ❖ Proof of receipt of funds



# SALE OF REAL ESTATE

- ❖ If the property is sold and closed, then the HUD-1 Settlement Statement must be obtained evidencing the final net proceeds due/from the seller
- ❖ If the property is listed or sold, then take the sales price less the mortgage and any other liens, less the realtor commission and expenses (using 10% of the sale price is a common method). The net amount will be a good estimate of the funds that will be available
- ❖ Commission may be used if the borrower's entitlement is documented
- ❖ Commission may be gifted from family member provided documentation reflects entitlement and gift





# INVESTMENT FUNDS

- ❖ Typically investment funds such as stocks and bonds are held in a portfolio account, the investment statement or letter from stockbroker reflecting the number of shares held and the current value are acceptable documentation
- ❖ In some cases, the borrower may have actual stock certificates or bonds. In these cases, obtain copies of the certificates/bonds along with the current newspaper listing their value.



# RETIREMENT FUNDS

- ❖ For retirement funds, the most recent account statement must be reviewed
- ❖ Only 60% of the vested amount may be used
- ❖ Liquidation is not required



# EARNEST MONEY DEPOSIT

- ❖ Large deposits exceeding 2% or more of the sales price must be verified
- ❖ A copy of the cancelled check or bank statement reflecting the funds are/were available to cover the amount must be obtained
- ❖ In lieu of the canceled check, a letter from the title company holding the money is acceptable as long as bank statements support the funds are sufficient to cover the check provided.



# RESERVES

- ❖ Required for all loans involving 3-4 unit properties.
  - ❖ Reserves must equal or exceed 3 months PITI
  - ❖ Excess gift funds may not be counted as reserves
- ❖ Effective with case numbers issued on or after April 21, 2014, reserves will also be required for manually underwritten loans involving 1-2 unit properties
  - ❖ Reserves must equal or exceed 1 months PITI
  - ❖ Reserves must be from borrower's own funds. May not include gifts or funds from the loan transaction
  - ❖ **REFERENCE:** ML 2014-02
- ❖ No reserve requirement for loans involving 1-2 unit properties that receive an Accept scoring recommendation





## SECONDARY FINANCING

- ❖ Any financing other than the first mortgage that creates a lien against the property is considered secondary financing. Such financing is not considered a gift, even if it is a "soft" or "silent" second, or has other features forgiving the debt
  - ❖ A "soft" or "silent" second is secondary financing with no monthly repayment provisions
- ❖ The lender must obtain from the provider of any secondary financing, and submit documentation showing the amount of funds provided to the borrower for each transaction, and copies of the loan instruments



# SECONDARY FINANCING

- ❖ Secondary financing may be provided by a government agency or instrumentalities of governmental agencies, non-profit organization, private individual(s) or organization(s), and family member(s)



## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

**Federal, State, and Local governmental agencies must comply with the following conditions:**

- ❖ FHA-insured first mortgage, when combined with the second mortgage – as well as any mortgages, grants, gifts, etc. – cannot result in cash back to the borrower (except for documented POCs for the appraisal/credit reports)
- ❖ The sum of all financing – Combined Loan-to-Value (CLTV) – cannot exceed 100% of the acquisition cost. Acquisition Cost is defined as sales price, borrower paid allowable closing costs, discount points, and pre-paid expenses (cannot include any amounts paid by another party), and repair and rehabilitation expenses





## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

**Federal, State, and Local governmental agencies must comply with the following conditions:**

- ❖ The required (total fixed) monthly payment cannot exceed borrower's ability to pay
- ❖ The source, amount, and repayment terms must be disclosed in the mortgage application. The borrower must acknowledge that he/she understands and agrees to the terms of the mortgage



## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

- ❖ Interpretive Rule published in Federal Register on December 5, 2012
- ❖ Per Mortgagee Letter 2013-14, loans that originated as part of the homeownership programs for Government Entities, which include funds provided toward the borrower's required minimum investment are eligible for FHA financing provided the mortgagee is in compliance with sections 203(b)(9)(A) and (C) of the National Housing Act.



## GOVERNMENTS, AGENCIES, INSTRUMENTALITIES

- ❖ Government or agency providing funds for borrower's minimum cash investment must have incurred prior to closing an enforceable legal obligation to fund the borrower's the funds
- ❖ The lender cannot provide blanket statements in regards to any agreement made between them and the Government Entity concerning reimbursement of funds legally belonging to the lender to fund the required investment



## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

- ❖ Documentation must be case specific and include specific language that establishes the funds were legally belonging to the Government Entity
- ❖ Acceptable documentation includes cancelled checks, evidence of wire transfer or other draw request showing that prior to or at the time of closing the Government Entity had authorized a draw of the funds on its account; or a letter from the Government Entity, signed by an authorized official



## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

- ❖ Lenders are not required to document the actual transfer of funds; however failure of the Government Entity to satisfy the obligation or liability may result in a determination that the funds were provided by a prohibited source
- ❖ Gift letters and the required documentation evidencing the provision of the borrower's required minimum investment in compliance with the Interpretative Rule must be included on the right-side of the case binder



## **GOVERNMENTS, AGENCIES, INSTRUMENTALITIES**

- ❖ In cases where the Government Entity cannot legally or operationally ensure that secondary financing is “made” by the Government Entity, FHA will permit the secondary financing component to be made by an FHA-approved mortgagee or FHA-approved non-profit on behalf of the Governmental Entity provided the mortgagee or non-profit is not a prohibited source and the Government Entity holds the secondary financing prior to endorsement of the first mortgage for FHA insurance until further notice



# GIFT FUNDS

- ❖ In order for funds to be considered a gift, there must not be an expected or implied repayment of the funds to the donor by the borrower
- ❖ The portion of the gift not used to meet closing requirements may be counted as reserves except on loans involving 3-4 unit properties
- ❖ Effective with case numbers issued on or after April 21, 2014, excess gift funds may not be used as reserves for manually underwritten loans



# GIFT FUNDS

## Acceptable gift fund donors include:

- ❖ the borrower's relative
- ❖ the borrower's employer or labor union
- ❖ a close friend with a clearly defined and documented interest in the borrower
- ❖ a charitable organization
- ❖ a governmental agency or public entity that has a program providing home ownership assistance to low- and moderate-income families, or first-time homebuyers





# GIFT FUNDS DOCUMENTATION

- ❖ Gift funds must be noted on the 1003 unless already deposited in an account disclosed on the 1003
- ❖ The file must include a copy of the gift letter that specifies:
  - ❖ donor's name, address, and telephone number
  - ❖ relationship between the donor and the borrower
  - ❖ the dollar amount and when the gift was given/will be given
  - ❖ Contain language certifying there is no repayment required





## **DOCUMENTING TRANSFER OF GIFT FUNDS**

- ❖ The lender must document the transfer of the gift funds in accordance with HUD guidelines (i.e. evidence of deposit or wire transfer, copy of check)
- ❖ Transfer of the gift funds include sourcing the funds provided
- ❖ Regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source, and were the donor's own funds



# DOCUMENTING TRANSFER OF GIFT FUNDS

## Acceptable documentation includes:

- ❖ a copy of the cancelled check drawn on the donor's personal account; or
- ❖ copy of the official check or certified check made on the donors account along with a copy of the bank statement or a letter from the donor's bank on bank letterhead certifying the donor had the available funds; or
- ❖ other documentation showing the withdrawal is from the donor's personal account



# GIFTS OF EQUITY

- ❖ Gift of equity provided from a family member may be used as source of funds
- ❖ Gift letter must also be provided
- ❖ Must be listed on the contract of sale and should be reflected on the HUD-1 Settlement Statement as a deposit



# AUTOMATED UNDERWRITING





# AUTOMATED UNDERWRITING

An Automated Underwriting System (AUS) is computer-based process that evaluates the borrower's:

- ❖ Willingness to repay the loan (credit) based on borrower's credit history derived from the three credit bureau databases
- ❖ Ability to repay the loan (capacity) from the information entered by the lender. The data is analyzed using predetermined set of parameters (scorecard), which returns a recommendation of approval or refers the loan for manual underwriting



# AUTOMATED UNDERWRITING

- ❖ AUS does not review specific program requirements nor property eligibility
- ❖ All loans must be scored through an AUS that can communicate with the TOTAL (Technology Open To Approved Lenders) Scorecard except for
  - ❖ loans where no borrower has a credit score
  - ❖ streamline refinances
  - ❖ Home Equity Conversion Mortgages (HECMs)



# AUTOMATED UNDERWRITING

- ❖ the FHA case number must be entered in order for TOTAL Scorecard Emulator to communicate with the AUS used to score the loan
- ❖ DATA INTEGRITY IS ESSENTIAL



# AUTOMATED UNDERWRITING

Automated underwriting DOs include:

- ❖ **DO** ensure that the information used to complete the FHA Insurance Application matches the information used on the latest or most recently saved AUS submission
- ❖ **DO** downgrade the AUS recommendation to REFER if the borrower has undergone a foreclosure or short sale within the previous 3 years – even if not considered by the AUS
- ❖ **DO** downgrade the AUS recommendation to a REFER for cash-out refinance transactions with an added non-occupant co-borrower





# AUTOMATED UNDERWRITING

**Automated underwriting DOs include:**

- ❖ **DO** downgrade the AUS recommendation to a REFER if the disputed account is more than \$500 AND is less than 24 months old
- ❖ **DO** ensure compliance with any credit issues not considered by the AUS which may affect the eligibility for FHA-insuring
- ❖ **DO** ensure that the HUD 92900-A is executed correctly as an AUS Approved loan



# AUTOMATED UNDERWRITING

**Automated underwriting DON'Ts include:**

- ❖ **DON'T** process the loan without an FHA case number
- ❖ **DON'T** proceed with an AUS recommendation of ACCEPT for borrowers who have been discharged for less than 2 years from Chapter 7 or 13
- ❖ **DON'T** downgrade the AUS recommendation for cash-out refinance transactions for non-occupying co-borrowers who were on the original transaction.



# AUTOMATED UNDERWRITING

**Automated underwriting DON'Ts include:**

- ❖ **DON'T** proceed with the AUS recommendation of ACCEPT if the disputed account hasn't been settled/resolved, reflected w/\$0 balance, OR is BOTH \$500 and 24+ months old
- ❖ **DON'T** forget to re-submit the loan if the borrower's liability is greater than \$100/month
- ❖ **DON'T** enter ZFHA in the FHA Insurance Application screen if the loan has been downgraded to a REFER and approved as a manual underwrite





# TOTAL SCORECARD UPDATES

- ❖ **On July 21, 2012 new input fields were implemented**
  - ❖ borrower paid closing costs
  - ❖ Current housing expenses
  - ❖ Gift letter amount
  - ❖ Gift letter source
  - ❖ Required investment
  - ❖ Total closing costs
  - ❖ Total fixed payment
  - ❖ Seller concessions
  - ❖ Down payment
- ❖ **On April 1, 2013** Version 3.2 was implemented to reflect the recent policy change for FICO scores and required investment





# Questions?